



**STATEMENT FOR THE RECORD**

**OF**

**THE AMERICAN INSTITUTE OF ARCHITECTS**

**FOR THE HEARING ON**

**“CERTAIN EXPIRING TAX PROVISIONS”**

**BEFORE**

**THE U.S. HOUSE OF REPRESENTATIVES**  
**COMMITTEE ON WAYS AND MEANS**  
**SUBCOMMITTEE ON SELECT REVENUE MEASURES**

**APRIL 26, 2012**

The American Institute of Architects (AIA) appreciates the opportunity to submit this statement for the record and commends the Subcommittee's work on the critical issue of expiring tax provisions.

Given the critical economic, security, and environmental considerations surrounding the energy sector, the issue of energy tax policy is an important consideration as extensions are considered. Although there are numerous tax policies that impact energy policy and the built environment, our statement focuses on an energy efficiency and conservation tax provision, the Energy Efficient Commercial Building Deduction, which is contained in section 179D of the Internal Revenue Code. Although not an expiring provision this year (it is set to expire in 2013), the AIA highlights the 179D deduction as an example of one provision in the energy tax family that has had a demonstrable effect on energy efficiency investment, domestic manufacturing, and design and construction industry jobs.

The 179D deduction has leveraged billions of dollars in private capital, resulted in the energy-efficient construction or renovation of thousands of buildings, and created or preserved hundreds of thousands of jobs in the process. Due to its success in the field, 179D is a good indicator of the positive impact extensions of renewable energy and energy efficiency incentives can have on the economy.

In recognition of the benefits of the section 179D deduction, there have been reform proposals offered in recent months aimed at further enhancing the important tax benefit. The AIA supports reform of the 179D deduction that makes it simpler and more accessible. As these discussions progress, the AIA also strongly urges Congress to consider enhancements to 179D that would provide an effective and efficient way to encourage investments in energy efficiency, stimulating construction activity and jobs during this fragile time in the nation's economy.

The AIA represents over 75,000 architects and emerging professionals nationwide and around the world. As a leader in the design and construction industry, the AIA supports incentivizing energy efficiency in a myriad of ways, but particularly through provisions like 179D, that have proven to be quite successful in the field.

The AIA strongly supported this provision when it was enacted as part of the Energy Policy Act of 2005. The AIA also helped form a partnership with other concerned stakeholders and through this partnership, developed implementation recommendations for building owners to obtain this tax deduction. In 2008, the AIA helped pass legislation to extend the life of the deduction so that it covers property placed in service by December 31, 2013. That same year, at the AIA's urging, the [IRS issued guidance](#) on how the deduction could be allocated to the designer.

The AIA was pleased with the initial clarification that this IRS guidance provided, and many agencies on the federal, state and local levels followed suit by issuing policies on the allocation of this deduction.

## **Background on Section 179D, the Energy Efficient Commercial Building Deduction**

The Energy Efficient Commercial Building Deduction was created by the Energy Policy Act of 2005 (Pub. L. No. 109-58), in recognition of the fact that a substantial portion of U.S. energy consumption is attributable to commercial buildings and to provide a tax incentive to help offset the costs associated with enhancing their energy efficiency. Section 179D provides a deduction for certain energy-efficient commercial building property expenditures.

Eligible expenditures are for property which is: (1) installed on or in any building that is within the scope of Standard 90.1-2001 of the American Society of Heating, Refrigerating, and Air Conditioning Engineers and the Illuminating Engineering Society of North America (“ASHRAE/IESNA”); (2) installed as part of the (i) interior lighting systems, (ii) heating, cooling, ventilation, and hot water systems, or (iii) building envelope; and (3) certified as being installed as part of a plan designed to reduce total annual energy and power costs by 50 percent or more. The deduction is effective for property placed in service prior to January 1, 2014.

The maximum deduction is \$1.80 per square foot. In the case that a building does not meet the 50 percent energy savings requirement, a partial deduction of \$0.60 per square foot is allowed for each separate building system that comprises energy-efficient property and that is certified as meeting required savings targets. To encourage the public sector to utilize these same energy efficient enhancements, the 179D deduction also provides a federal, state, or local government owner of a commercial building an election to allocate the tax deduction to the primary person responsible for designing the energy efficient enhancements installed in the building.

Building owners who take advantage of 179D not only enjoy a deduction for qualifying levels of efficiency but also enjoy significantly lower energy costs down the road, the benefits of leading edge design and construction which enhances the building’s long term market value, and the benefits of a cleaner environment overall. Owners have utilized the deduction for both new construction projects and retrofits of existing buildings.

Although a public entity cannot take advantage of the tax proceeds from the 179D deduction allocation, it will also receive other benefits in the form of energy savings and market value, often totaling more than the deduction proceeds received by the designer.

The average 179D project (typically \$0.60/ sq. ft. for lighting upgrades) saves an agency an average of 20 percent on their energy expenses. However, even in cases where there are minimal upgrades that qualify for 179D, agencies have saved relatively large amounts.

For example, when a middle school set out to retrofit its lighting system, an architect worked to find 12 percent energy savings just on that single lighting system. The system then qualified for the 179D partial lighting deduction. In return, the school saved \$15,000 on its energy bill in that year alone. It saved even more the next year, and will continue to save each year. Over 10 years, that totals to over \$150,000, for a single school. School districts that take advantage of 179D for five, 10, or 20 schools can save millions of dollars over 10 years, at no additional cost to them, because they can utilize the 179D deduction to finance the additional energy savings.

This example illustrates the impact of just 12 percent energy savings in a single school. There are hundreds of other examples of the deduction providing even greater benefits to school districts, army bases, civic structures, and other publicly owned buildings across the nation.

### **Proposals to Improve the 179D Deduction**

There have been reform proposals offered in recent months aimed at further enhancing this important tax benefit. AIA supports commonsense efforts that make 179D more usable, effective and simpler. As these discussions progress, the AIA, in particular, strongly urges Congress to consider three key improvements to 179D: (1) ensuring the ability of pass-through entities to capture the full value of an allocated deduction in the case of a public owner of a building; (2) enhancing the value of the 179D deduction; and (3) allowing non-profit owners of buildings, similar to public owners of buildings, to allocate the deduction.

#### ***Allocating the Section 179D Deduction to a Pass-Thru Entity***

The section 179D deduction provides a federal, state, or local government owner of a commercial building an election to allocate the tax deduction to the primary person responsible for designing the energy efficient enhancements. In December 2010, the IRS released a memo that effectively prevents design firms organized as partnerships or S corporations from fully realizing the benefit of a section 179D allocated deduction.

This problem is not merely theoretical – almost 80 percent of architectural firms have fewer than 10 employees and a significant number of these small businesses are organized as partnerships and S corporations. Moreover, it is often these small and mid-size firms that work on state and local government projects such as schools.

By way of background, an allocated section 179D deduction is a tax deduction that does not reflect an economic cost to the recipient taxpayer, because similar to a tax credit, the deduction provides an incentive. The technical tax rules nonetheless treat an allocated deduction as reflecting an economic cost to the taxpayer and accordingly reduce partnership and S corporation taxable income *and* the partners'/shareholders' basis in the partnership/S corporation (*i.e.*, “outside basis”) by the amount of the allocated deduction. The reduced outside basis may force partners and S corporation shareholders to recognize taxable gain on the distribution of economic earnings that were excluded from tax by the allocated section 179D deduction at the partnership and S corporation level. The IRS memo states that, in the absence of explicit statutory authority allowing for basis adjustments to preserve the benefit of the deduction at the partner or shareholder level, the technical tax rules govern. The result will be that, in the case of many partnerships and S corporations, the benefit of the section 179D deduction will be lost or significantly diminished. This will harm not only these firms, but also the school districts and other public entities who own the buildings.

In order for partnerships and S corporations to obtain the intended benefits, it is necessary for partners and S corporation shareholders to obtain a basis in their partnerships and S corporations that is not reduced by an allocated 179D deduction. This issue could be addressed by a simple modification to expressly require Treasury to issue regulations that properly determine partnership or S corporation outside basis in the case where the 179D deduction is allocated.

Such a clarification would provide certainty and address a widespread concern among many small businesses that design energy efficient buildings.

### ***Enhancing the Section 179D Deduction***

The impact of the section 179D deduction has become muted over time. The maximum deduction of \$1.80 per square foot has not been increased since the deduction was put in place in 2005 and, as a result, has not kept pace with inflation. Moreover, as the economy and financial markets continue their fragile recovery, the amount of capital available for building design, construction, and renovation continues to be limited. A recent AIA survey of architecture firms shows that nearly two-thirds report that a lack of financing has slowed or stopped construction projects that would create jobs. Owners are also less likely to invest the upfront capital costs associated with energy efficient systems, which often are somewhat more expensive to design, build, and install than their less efficient counterparts.

In 2010, a coalition of more than 80 organizations and companies called on Congress to increase the 179D deduction from the current maximum allowable amount of \$1.80 per square foot to \$3.00 per square foot. In the case of individual subsystems, the maximum allowable deduction should be increased from \$0.60 per square foot to \$1.00 per square foot. Bipartisan legislation was introduced in both chambers in the 111<sup>th</sup> Congress to enhance the deduction in this way.

Enhancing the 179D deduction would provide an important source of additional capital to stimulate building design, construction, and renovation, driving the creation of well-paying jobs. Studies have shown that every \$1 million invested in design and construction yields 28.5 full-time jobs. Moreover, an enhanced section 179D deduction would further incentivize energy efficiency, improve the nation's commercial building stock, and increase energy independence.

### ***Allocating the Section 179D Deduction in the Case of a Non-Profit Owner of a Building***

The 179D deduction allocation provision, which allows a federal, state, or local government owner of a building to allocate the deduction to the designer, has been used to great effect by design professionals to encourage their public sector clients to meet the energy targets of the deduction and then have the client assign them the tax deduction. The result has been more energy efficient public buildings, lower energy costs for the building owners, and tax relief for design professionals.

In many cases, non-profit entities, such as hospitals, universities, private schools, charities, and foundations, conduct functions similar to state and local governments. Currently, non-profit entities own thousands of properties across the country. Although retrofits to these properties could result in significant energy savings, the non-profit entities do not pay taxes and, consequently, cannot benefit from the section 179D deduction.

The section 179D allocation provision should be expanded to provide non-profit owners of buildings, similarly to public owners of buildings, with the ability to elect to allocate the deduction to the primary designer of the building. Such a provision would assist non-profits in financing energy efficiency upgrades and would reduce their energy costs in the longer-term.

**Conclusion**

The AIA appreciates the opportunity to submit this statement for the record. As Congress considers expiring tax provisions, it is important to recognize the impact the 179D deduction has had in leveraging private capital and increasing energy-efficient construction and renovation. Modest improvements to the section 179D deduction would increase the effectiveness and efficiency of this important tax policy. The AIA and its members are ready to serve as a resource to Congress, the Committee, and the Subcommittee on these and other issues.

